The CPA Journal

# Peer Review: An Emerging Niche Market

*By James Schmutte and John R. Thieling*

JULY 2008 - The AICPA's Peer Review Program began more than 30 years ago as a voluntary program. It has since been incorporated as an AICPA membership requirement for individuals in public practice. Several of the AICPA's audit quality centers (such as the Governmental Audit Quality Center and Employee Benefit Plan Audit Quality Center) either require peer review for membership or require that member firms make their peer review reports readily available to the public. Peer review is now a licensing requirement for accounting firms in more than 40 states. Additional jurisdictions are either implementing enacted legislation or working toward mandatory peer review requirements.

State peer review licensing requirements are structured around, and incorporate, the AICPA's Peer Review Program. The movement of peer review from a voluntary aspect of practice to a licensing requirement has created a demand for CPAs to participate as reviewers in the profession's self-regulatory efforts. This has created an opportunity for public accounting firms to expand their line of services.

The decision to become a peer reviewer should be approached in the same manner as expanding into any new line of service. The following factors should be evaluated: the market demand for the service, the competition from other service providers, the cost and investment required to support the service, the pricing of the service, the institutional support, and the potential additional benefits (e.g., firm reputation, networking opportunities) that might accrue from providing the service.

## The Market for Peer Review Services

When deciding whether to offer peer review services, an obvious starting point is the extent of the market for peer review services. In 2006, the AICPA reported that more than 37,000 firms enrolled in the AICPA Peer Review Program ("Questions and Answers About the AICPA Peer Review Program, Update No. 7," January 2007, www.AICPA.org). Approximately 30,000 of these firms are required to have a peer review at least once every three years. As illustrated in Exhibit 1, firms with five or fewer professionals dominate the AICPA's program (see Susan Coffey, "Professional Developments Impacting the Peer Review Program," 2007 AICPA Peer Review Conference). Accordingly, no CPAs should think that their firm is too small to provide peer review services.

Just as practitioners should not rule out providing peer review services because of the size of their firm, they should not think that the nature of their accounting practice precludes them from becoming a peer reviewer. As illustrated in Exhibit 2, the majority of peer reviews are not systems reviews. In other words, CPAs in firms that do not perform audits are eligible to perform peer reviews on other firms that do not perform audits.

Accounting firms without an accounting or audit practice are exempt from peer review requirements; nonetheless, several factors will continue to feed the demand for peer reviews. The National Association of State Boards of Accountancy (NASBA) continues to push for peer review as a requirement for firm licensing. With the addition of peer review as a licensing requirement in states where it is not currently required, the number of firms seeking peer reviews is likely to increase significantly. For example, the implementation of the peer review licensing requirement in Indiana brought nearly 300 new firms into the peer review process. This represented a 33% increase in the number of reviews being performed.

In addition to its growing importance as a licensing requirement, peer review continues to be a requirement for performing audit engagements subject to GAO Yellow Book standards. Along with the regulatory requirements that mandate peer review, organizations are encouraged to request peer review reports as part of the CPA firm selection criteria when contracting accounting or auditing services (see the AICPA's toolkits for audit committees). These forces can be expected to provide a stable and growing demand for peer review services.

**Competition in the Market for Peer Review Services**

All reviewers are listed in the AICPA's reviewer database, but only those approved by the state society administering the review are authorized to perform peer reviews within that jurisdiction. There is currently a critical shortage of qualified peer reviewers. An AICPA study, "Board of Directors Peer Review Task Force Report: Recommendations for Enhancing the AICPA Peer Review Programs in a Transparent Environment" (February 9, 2006), reported that in 2004 there were 1,793 practitioners qualified as peer reviewers, and only 1,444 met the requirements to serve as team captain on a system review (the equivalent of the engagement partner in an audit situation). The significance of these numbers is that each is the product of a steady decline in both reviewers and team captains since 2001. During the period 2001– 04, the number of reviewers decreased 15%, with a corresponding decrease in the number of team captains.

With a growing demand for peer review services and a simultaneous decline in the size of the reviewer pool, the number of peer review engagements performed annually by reviewers has increased significantly. During the period 2001– 04, the proportion of reviewers who performed six or more peer reviews each year increased 24%. Team captains experienced an even greater increase in the number of engagements performed annually. In 2001, team captains who performed six or more peer reviews annually represented 34% of the reviewer pool. By 2004, more than 40% of team captains led six or more reviews each year.

To compound the problem, the pool of reviewers and team captains is not only shrinking in size, but also aging (Exhibit 3). Absent an influx of new reviewers and team captains, the pool of qualified reviewers and team captains will continue to shrink, creating an even greater demand for qualified peer reviewers.

**Resource Investment**

Firms with a significant accounting or auditing practice will require little, if any, additional investment of firm resources to add peer review as a service line. Existing resources may, however, require some redirection. The resource most directly affected by the decision to provide peer review services is firm personnel. Due to the nature of the peer review process and the AICPA's reviewer requirements, only firm personnel at the partner and supervisory levels are eligible to be a peer reviewer. The AICPA requires that a peer reviewer meet the following requirements:

- Be a member of the AICPA in good standing, licensed to practice as a CPA in a firm that has received an unmodified report for its most recent system or engagement peer review that was accepted within the last three years and six months;
- Possess current knowledge of applicable professional standards, including quality control and

peer review;

- Have at least five years of recent accounting or auditing experience in public accounting;
- Be currently active in public accounting as a partner or manager (or with equivalent supervisory responsibilities) in the accounting or audit function in a firm enrolled in an approved practice monitoring program; and
- Complete a peer review training course that meets the requirements established by the AICPA Peer Review Board (PRB), when the function of the reviewer goes beyond reviewing engagements.

In addition to the above requirements, to qualify as a team captain on a system peer review, one must be a partner in an enrolled firm that has received an unmodified report on a review on its system of quality control for its accounting and auditing practice for its most recent peer review that was accepted within the last three years and six months. CPAs in firms that do not perform audit engagements but received an unmodified engagement peer review report are qualified to perform engagement and report reviews which, as illustrated in Exhibit 2, represent half of the market for peer review services.

**Revenue Considerations**

While the out-of-pocket costs to qualify as a peer reviewer or team captain may be minimal, there are some questions regarding the revenue stream generated by peer reviews. Will the new service provide adequate revenue growth? Will billable time be diverted from traditional client services? The answer to these two questions is a function of the number of traditional billing hours affected by the peer review engagements, the number of peer reviews performed, and the billing rate for the peer review service.

The decision to add peer review services does not necessarily mean a reduction of services to existing clients; it is more a matter of determining how to market the firm's services. The development of a peer review practice will most likely be a gradual process, as the reviewer's experience and reputation grow. While some traditional accounting and auditing clients may be culled out to free up time for the new peer review service, these decisions should be based on standard criteria for evaluating client relationships.

Other considerations related to peer review engagements are the timing of the workload and the types of peer reviews. Peer review engagements are primarily performed during the summer and fall, when firms traditionally have a greater capacity to absorb new engagements. In addition, engagement and report peer reviews, which represent more than half of peer reviews, are performed in the reviewer's office and do not require travel or on-site time. The peer review practice could be limited to report and engagement reviews. This would allow the peer review engagements to be worked into the reviewer's schedule without necessarily disrupting service to existing clients.

In the past, peer review pricing was unduly influenced by the fee structure prescribed by the Committee Appointed Review Team (CART) service sponsored by the AICPA and its administering entities. Under the CART program, firms seeking a peer review were matched with a reviewer by the program's administrators, and the corresponding fees were based on the AICPA's established rate structure. Many state administering entities have eliminated their CART program, and the CART fees are no longer applicable or published. Unfortunately, these discounted billing rates carried over into the firm-on-firm market.

The resulting fees were not "market driven" but were artificially established, and on the low end. In fact, the AICPA's recent study on the peer review program acknowledged that low fees were a contributing factor in the decline in the number of reviewers noted above. Currently, market forces are pushing peer review billing rates to levels more comparable to those for other professional services. Both hourly and fixed fees have been adjusted upward to reflect full realization rates.

If a reviewer has experience in certain industries or audits such as Yellow Book, A-133, or ERISA, there is an even greater demand for these specialized peer review services. Reviewers with such experience will find demand not only from firms seeking peer review, but also from other peer review teams that need a member with that expertise for reviewing engagements. In other words, the reviewer can either undertake full responsibility for a peer review (team captain) or function as an outside expert (team member).

Being a reviewer can lead to other CPA-to-CPA services. With mandatory peer review as part of firm licensing, many firms will have to address quality-control issues such as monitoring and inspections, which can be difficult to implement internally. Purchasing these services from a peer reviewer may be an optimal solution. Limiting the services to non–peer review clients would avoid any independence issues for peer reviewers. In a similar vein, a peer reviewer could provide ongoing consultation or engagement pre-issuance review services to non–peer review clients. Because peer review is a licensing requirement, accounting firms are increasingly looking for cost-effective ways to address quality-control implementation.

Unlike audit engagements, peer reviews and related services must be performed exclusively by firm personnel with extensive experience and expertise; leveraging lower-level staff is not possible. Accordingly, the fee structures for peer review services should reflect the experience and expertise of the managers and partners performing the reviews.

**Institutional Support**

The AICPA's Peer Review Program is a national program in terms of review standards, performance requirements, and general administration, yet the program is implemented and administered at the state level by the state CPA societies. The AICPA's PRB is responsible for issuing peer review standards and guidance, as well as overseeing the activities of the state CPA societies administering the program. The state administrating bodies are responsible for scheduling reviews, accepting reports, and overseeing their own activities.

Once one meets the reviewer qualifications, the initial step is to register as a reviewer by entering a resume into the AICPA's reviewer database via the AICPA's website. Once registered, a reviewer can be approved to perform specific reviews. The AICPA does not pair reviewers with firms seeking reviews. Reviewers are approved by the states' administering entities, based on a matching of the reviewer's experience and the industry specialization within the reviewed firm's practice, as entered into the AICPA's database.

In an effort to ensure consistency in the performance and administration of peer reviews, the PRB provides a wealth of free resources to assist and guide reviewers and team captains. These aids, available on the AICPA's website, include checklists, practice aids, and authoritative guidance materials from the PRB. The required forms and checklists associated with performing the various types of peer review engagements are available for download. To further assist the peer reviewer, the AICPA has added an additional "practice management tool kit" to facilitate and enhance communication between the peer reviewer and the firm under review.

Peer review standards do not change often—a recently announced revision in the standards is scheduled to go into effect January 1, 2009—but addressing their interpretation and implementation is often necessary as practice issues arise. The PRB periodically issues the *Reviewer's Alert* to address such issues. The publication, which is available on the AICPA's website, provides the reviewer with the position taken by the PRB in terms of the peer review implications of matters such as the impact of a firm's failure to comply with Rule 101-3 on independence. While the purpose of the guidance is not to remove the reviewer's professional judgment in resolving a matter, the intent is to inform reviewers of the PRB's position and what might be considered appropriate in certain peer review situations.

A further resource available to reviewers is direct access to the AICPA's Peer Review Program's technical managers. Reviewers are free to call for technical guidance when addressing any unusual or unique performance or reporting situation that may arise. The technical managers can either direct the reviewer to the guidance within the literature or provide their interpretation of the situation based on their experiences in working with the PRB and assisting other reviewers.

The reviewer also has free access to the resources available through the state society. Each administering entity has a peer review program administrator who can assist the reviewer in resolving matters associated with scheduling reviews and dealing with the AICPA and the particular state's peer review committee. For technical matters, the administrator may refer the reviewer to the state's technical reviewer.

Technical reviewers function as the link between the state's peer review committee and the team captain or reviewer. Prior to a review being presented to the state's peer review committee for final acceptance, a technical reviewer reads the peer review report, letter of comments (if issued), letter of response (if issued), and the review's associated documentation. The technical reviewer is responsible for verifying that the review was performed in accordance with peer review standards, that the findings were handled consistent with PRB guidance, and that the peer review engagement's documentation is complete and internally consistent. If there are any questions regarding the review, the technical reviewer works directly with the reviewer or team captain to resolve the issues before it is presented to the committee.

The technical reviewer has extensive experience in dealing with all aspects of the peer review process. The reviewer has the opportunity to present and discuss any situation with the technical reviewer before the peer review is submitted to the state society. By taking advantage of the technical reviewer's services while the review is still in process, a reviewer can address the issue, speeding up the completion and acceptance of the review and yielding a higher realization.

**Additional Benefits**

Being a peer reviewer can yield a number of nonmonetary benefits to the individual reviewer and to the firm. When experienced reviewers are asked what they get out of being a peer reviewer, a common response is that it keeps them "on top of their game." Being a peer reviewer enhances their knowledge and skill. Reviewers benefit from the opportunity to observe other firms' quality-control systems in action. The reviewers also see how firms implement new professional standards and address unique accounting or auditing situations. This allows reviewers to not only share their experiences but also benefit from those of others.

Peer review also creates a forum in which the reviewer and the firm's personnel often discuss nontechnical matters beyond the scope of peer review. Shared concerns related to practice management, technology, purchased services, recruiting, and staffing are often discussed during a peer review.

Peer review originated as an educational program to provide an opportunity for practitioners to share the experiences of their peers. While peer review has evolved into an element of the regulatory environment, the original intent and spirit of the program continue. In most peer review engagements, both the reviewer and the firm come away better for the experience.

**Marketing Peer Review Services**

With the decision to add peer review to the firm's portfolio of services comes the question of how to market the new service. Most engagements will come from firms seeking the reviewer's services, rather than traditional marketing efforts where the reviewer is "selling" the service. As with other professional services, once the peer review practice is established, new business will come by way of referrals from existing clients.

The AICPA's toolkit includes marketing and sales ideas, sample letters to prospective firms, management tools to track and monitor prospects, as well as questions and answers to develop a commitment within the firm to support the peer review practice.

New reviewers must accept the reality that a peer review practice will start with only a few engagements. Over time, however, the practice will expand as existing clients spread the word. On the plus side, gradual growth allows a firm to absorb the new engagements without disrupting service to the firm's other traditional clients.

A firm's initial source of peer review engagements will most likely be through the AICPA's reviewer database. Firms preparing for their first peer review and those looking to change reviewers utilize the database to identify potential reviewers. The database allows searches for reviewers based on state, industry experience, and practice areas. From the results of the initial search, secondary descriptive information about each reviewer and his firm is available. By using the database, a firm seeking a peer reviewer can find one who meets the stipulated criteria. As a firm's peer review client base develops, it should expect additional referral engagements.

**Myths and Misconceptions**

Some CPAs may be hesitant to enter the peer review market due to a perception that many engagements present peer review problems that lead to lower realization rates. In fact, the vast majority of firms do not have significant reporting issues. More than 90% of systems and engagement reviews result in unmodified reports (Exhibit 4). Likewise, only a small minority of report reviews result in significant comments (Exhibit 5).

In addition, the AICPA's proposed changes in the peer review standards will roll report reviews into the engagement review model and eliminate the letter of comments (LOC) from the reporting model for both systems and engagement reviews. This change is anticipated to reduce the level of contention between the reviewer and the firm for the vast majority of peer review findings.

Realization rates on peer review engagements can be enhanced in a number of ways. As with any professional service, the starting point is the decision to accept the client. Initial inquiries into the nature of the firm's practice and its quality-control policies and procedures can help identify and avoid firms that may present peer review problems. Second, peer review services should be billed in line with other professional services. Third, peer review is similar to other professional service engagements in that efficiencies can be gained by incorporating templates, tools, practice aids, and technology wherever possible. While each peer review is unique, they all share documentation and paperwork that can be easily adapted to each engagement. Last, peer reviewers can head off engagement delays by consulting with the state administering entity and its technical reviewer as soon as problems appear.

Another common misperception is that the AICPA's and the state societies' oversight activities of the peer review program place an added burden on peer reviewers, subjecting their work to another round of scrutiny. Most of the oversight is performed behind the scenes and does not impact the peer reviewer. The state administering entity does, however, have a responsibility to examine a sample of the peer reviews performed each year. In the case of engagement and report reviews, the oversight is performed as an after-the-fact "desk review," which normally does not affect the reviewer. System review oversights are typically performed during the actual peer review and include a visit by a representative of the peer review committee who reviews work papers and sits in on the closing meeting between the team captain and the representatives of the reviewed firm. The cost of the oversight is absorbed by the administering entity and does not significantly add to the time or cost of the peer review to either the reviewer or the reviewed firm.

Some CPAs may be reluctant to invest their energy in developing a peer review practice under the belief that the future of the AICPA's program is uncertain in light of recent criticism of the quality of audit reports from the Department of Labor (DOL) and the Office of Management and Budget (OMB). In other words, will a federal program similar to the PCAOB's inspection program for auditors of public companies replace the AICPA's peer review program? Actions to date suggest that the DOL and Government Accountability Office (GAO) are taking actions that will not challenge the AICPA's program.

In 2005, the DOL began a new audit quality enforcement initiative aimed at improving the quality of ERISA audits. The new initiative uses a two-prong approach. Firms that perform a significant number of audits will be reviewed in a top-down manner similar to a PCAOB on-site inspection. Firms that perform only a limited number of employee benefit plan audits may have an engagement selected for a detailed in-house review that covers the report and selected workpapers.

Responding to the OMB's concerns over audit quality, the Audit Committee of the President's Council on Integrity and Efficiency (PCIE) undertook an in-depth study to statistically measure the extent to which single audits conform to applicable requirements and address audit quality issues. The report included three recommendations: revise OMB A-133 and related standards, establish minimum training and CPE requirements (similar to Yellow Book requirements), and enhance processes to address unacceptable audits and reviewers that do not meet training and CPE requirements.

One final concern that some CPAs have is that performing peer review services might expose them to an additional business risk by being associated with firms of questionable quality. With peer review increasingly a requirement for licensure, some fear that they may be pulled into an investigation or litigation related to a former peer review client. The information acquired in the performance of a peer review is subject to the same privilege by statute as is any other professional service. To date, there has been no reported instance of the work of a peer reviewer being used in conjunction with any investigation or litigation directed at a former review client.

**Most Likely to Succeed**

Admittedly, becoming a peer reviewer is not for everyone. CPAs active in the accounting or audit function will find the technical aspects of peer review a natural extension of their experiences. Likewise, CPAs who have assumed significant roles in the quality-control structure of their own firms will find an easy transition into the peer review function.

Individuals with strong people skills who are comfortable in the role of teacher or mentor will find being a peer reviewer personally rewarding.
Accounting practices have traditionally been structured around providing accounting and auditing, tax, and consulting services to the public and businesses. Peer review, whether self-imposed or mandated, has provided the public accounting profession with an emerging market for a unique service. Peer review should not be viewed solely as a regulatory requirement (whether state-imposed or voluntarily self-regulated). Peer review represents an opportunity for accounting firms to leverage their existing practice and knowledge into this related service.

---

***James Schmutte, DBA, CPA****, is a professor of accounting at Ball State University, Muncie, Ind. He has been a technical reviewer for the Indiana CPA Society peer review committee for more than 10 years.*
***John R. Thieling, CPA****, is a sole practitioner in Plymouth, Ind. He has been a peer reviewer for more than 30 years and serves on and has chaired the Indiana CPA Society's peer review committee.*

**EXHIBIT 1**
Firms Enrolled in AICPA Peer Review Program, by Size

| Number of Professionals | Firms Enrolled |
|---|---|
| Sole practitioner | 12,355 |
| 2–5 | 12,389 |
| 6–10 | 3,180 |
| 11–19 | 1,285 |
| 20–49 | 639 |
| 50–99 | 110 |
| 100 or more | 17 |

**EXHIBIT 2**
Distribution of Peer Reviews, 2004–2006, by Type of Review

| | |
|---|---|
| System | 48% |
| Engagement | 30% |
| Report | 22% |

**EXHIBIT 3**
Distribution of Team Captains and Reviewers, by Age

| Reviewers | 2001 | 2004 |
|---|---|---|
| Under 55 | 74% | 63% |
| 55 or older | 26% | 37% |
| **Team Captains** | | |
| Under 55 | 70% | 60% |
| 55 or older | 30% | 40% |

**EXHIBIT 4**

Distribution of Peer Review Reports, 2004–2006, by Type of Report

| Report Type | System Reviews | Engagement Reviews |
|---|---|---|
| Unmodified, no LOC | 50% | 50% |
| Unmodified, with LOC | 42% | 42% |
| Modified | 6% | 7% |
| Adverse | 2% | 1% |

**EXHIBIT 5**
Distribution of Report Reviews, 2004–2006, by Type of Report

| | |
|---|---|
| No Comments | 63% |
| With Comments | 32% |
| With Significant Comments | 5% |